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SUBJECT: ITALY--A YEAR-END ROUNDUP

1. SUMMARY: THIS MESSAGE IS INTENDED TO GIVE A SNAPSHOT
OF THE ITALIAN SCENE AS THE COUNTRY PAUSES FOR A TWO-WEEK
CHRISTMAS BREAK. AS THE YEAR ENDS, THE COUNTRY IS FACED WITH
RAPIDLY GROWING AND CLOSELY INTERRELATED POLITICAL AND ECONOMIC
CRISES, AND A DEEPENING MOOD OF PUBLIC FRUSTRATION AND
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RESIGNATION THAT INEVITABLY CONDITIONS AND COMPLICATES
EFFECTIVE ACTION TO RESOLVE THE IMMEDIATE PROBLEMS. THE
ECONOMIC AND POLITICAL CRISES WILL ALMOST CERTAINLY COME
TO A HEAD IN JANUARY. AT THAT TIME, IT APPEARS PROBABLE THAT
A TEMPORARY SOLUTION WILL BE WORKED OUT THAT WILL AVOID
COMMUNIST AND LAY PARTY DEMANDS THAT THE COMMUNISTS BE
BROUGHT INTO THE GOVERNMENT. THERE IS LIKELY TO BE LITTLE
REAL AGREEMENT, HOWEVER, AND THE BASIC PROBLEMS--BOTH
POLITICAL AND ECONOMIC--WILL REMAIN. PRESENT TRENDS, WHICH
SHOW NO SIGN OF BEING REVERSED, WOULD APPER TO FAVOR COM-

MUNIST PARTICIPATION IN THE GOVERNMENT IN THE NOT-TOO-DISTANT FUTURE. END SUMMARY.

THE SITUATION:

2. THE YEAR ENDS WITH THE COMMUNIST (PCI), SOCIALIST (PSI), AND REPUBLICAN (PRI) PARTIES (AND THE UNIONS) DEMANDING THE IMMEDIATE FORMATION OF A GOVERNMENT OF NATIONAL EMERGENCY (I.E., INCLUDING AT LEAST THOSE PARTIES AND THE CHRISTIAN DEMOCRATS (DC)) BECAUSE, IN THEIR VIEW, IT IS THE ONLY PRACTICAL WAY TO DEAL WITH THE GRAVE ECONOMIC AND SOCIAL PROBLEMS OF THE COUNTRY. GIVEN THE REAL AND THREATENED INCREASE IN UNEMPLOYMENT, THE DANGEROUSLY HIGH RATE OF YOUTH UNEMPLOYMENT (40 PER CENT OF THOSE UNDER 21), THE DECLINE IN INDUSTRIAL PRODUCTION, AND CONTINUING HIGH LABOR COSTS, THE NEED FOR AN EFFECTIVE ECONOMIC PROGRAM HAS TENDED TO BE THE DOMINANT ELEMENT IN THE DEVELOPING CRISIS. THE STABILIZATION MEASURES INTRODUCED EARLIER THIS YEAR, FOLLOWING THE STANDBY AGREEMENT WITH THE IMF, SUCCEEDED IN REDUCING INFLATION (FROM 20 TO 15 PERCENT) AND IN TURNING THE BALANCE OF PAYMENTS SITUATION AROUND. BUT IT DID SO AT THE COST OF A SLOWDOWN OF THE ENTIRE ECONOMY. THE WORSENING UNEMPLOYMENT PICTURE, WITH FEW PROSPECTS FOR NEW INVESTMENT, HAS LED TO DEMANDS, FROM THE UNIONS AND THE PARTIES OF THE LEFT, FOR
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A POLICY CHANGE THAT WOULD REINFLATE THE ECONOMY AND FOR A GOVERNMENT OF NATIONAL EMERGENCY TO ADMINISTER THAT POLICY.

3. ALL THIS TAKES PLACE AGAINST A BACKGROUND OF SHARPLY RISING PUBLIC CONCERN. THE COUNTRY IS BESET WITH PROBLEMS, WHICH SEEM TO GO FROM BAD TO WORSE. THE ECONOMIC PROBLEMS, MENTIONED ABOVE, WORRY EVERYBODY. A SEEMINGLY ENDLESS PARADE OF SCANDALS ATTACKS THE COUNTRY'S BASIC INSTITUTIONS (GOVERNMENT, BUSINESS, BANKING, MILITARY, ETC.). POLITICAL TERRORISM, PUBLIC VIOLENCE, AND CRIME HAVE CREATED AN ATMOSPHERE OF FEAR THAT HAS ALREADY AFFECTED THE DAILY BEHAVIOR OF THE AVERAGE CITIZEN, ESPECIALLY IN THE BIG CITIES. MUCH OF THE PUBLIC VIOLENCE IS DONE BY THE YOUNG WHO ARE INCREASINGLY ALIENATED AS THEIR EXPECTATIONS OF SOCIETY ARE DASHED. POLITICIANS ARE HELD IN INCREASING DISRESPECT AS THEY APPEAR TO BE FIDDLING WHILE ITALY BURNS. ALTHOUGH THIS INDICTMENT ALSO AFFECTS THE COMMUNISTS, THE NON-COMMUNIST PUBLIC IS INCREASINGLY RESIGNED TO THEIR PARTICIPATION IN GOVERNMENT. IN SHORT, THE ATMOSPHERE OF GLOOM AND DOOM IS WIDESPREAD, AS IS THE STRONG DESIRE THAT THE COUNTRY'S LEADERS POINT TO A CLEAR PATH OUT OF THE PRESENT MORASS OF SEEMINGLY INTRACTABLE PROBLEMS.

4. THE COUNTRY'S LEADERS, HOWEVER, DO NOT HAVE ANY DEMONSTRABLY EFFECTIVE SOLUTIONS TO THE URGENT ECONOMIC AND SOCIAL PROBLEMS. INDEED, THEY SEEM ENGROSSED IN THEIR OWN AND THEIR ORGANIZATIONS' FUTURES. THERE IS FAR MORE DISCUSSION, IN PUBLIC AND IN PRIVATE, OF THE DESIRED POLITICAL ARRANGEMENTS

THAN OF THE PROBLEMS THEY ARE EXPECTED TO RESOLVE. PRESIDENTIAL AMBITIONS ALREADY AFFECT THE BEHAVIOR OF INDIVIDUALS AND POLITICAL PARTIES. ALMOST ALL POLITICAL PARTIES ARE ON THE DEFENSIVE, EXCEPT FOR THE PCI AND EVEN IT BECOMES SO AT THE SUGGESTION THAT THE ELECTORATE BE CONSULTED. THE LAY PARTIES (PRI, PSI, PSDI, PLI) FEAR BEING SQUASHED BY THE GROWING COOPERATION BETWEEN THE PCI AND DC AND SEE A GOVERNMENT OF NATIONAL EMERGENCY AS THEIR TEMPORARY SALVATION. THE DC, STILL DOMINATED BY A HANDFUL OF PEOPLE MOST OF WHOM HAVE SECRET

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PRESIDENTIAL AMBITIONS, IS UNCERTAIN AND CAUTIOUS--AND TROUBLED BY A STILL SMALL BUT GROWING VOICE OF DISSENT WITHIN ITS RANKS WHICH OPPOSES THE DISPOSITION TOWARD COOPERATION WITH THE PCI.

WHY DOES THE CRISIS ARISE NOW?

5. THIS QUESTION NEEDS TO BE ASKED BECAUSE ITALY'S PRESENT ECONOMIC TROUBLES WERE BOTH PREDICTABLE AND PREDICATED AT THE TIME OF THE IMF AGREEMENT, AND THE LATER SIX PARTY ACCORD WAS, IN PART, A RATIFICATION OF THE COMMITMENTS TO THE IMF. GIVEN THAT HISTORY, WHY THE CRISIS NOW, LESS THAN SIX MONTHS AFTER THE SIX PARTY ACCORD?

6. THE SIX PARTY ACCORD AS MUCH MASKED DISAGREEMENT AS IT RECORDED AGREEMENT. WITH THE PASSING OF THE SUMMER LULL AND THE WORSENING OF THE ECONOMIC SITUATION IN THE FALL (INCREASED UNEMPLOYMENT, PRODUCTION FALLING OFF, AND THE PUBLIC SPENDING DEFICIT GROWING ALARMINGLY), THE PREVIOUS PAPERING OVER OF DISAGREEMENTS ON ECONOMIC POLICY BEGAN TO UNRAVEL. FACED WITH SIZEABLE LAY-OFFS (AND WITH MORE TO COME) THE TRADE UNIONS AND THE PARTIES OF THE LEFT BEGAN DEMANDING A RE-INFLATION OF THE ECONOMY TO CREATE JOBS AND PUBLIC SPENDING TO "SAVE" LARGE STATE-PARTICIPATION EMPLOYERS IN FINANCIAL DIFFICULTY. THESE DEMANDS COINCIDED WITH AND REINFORCED THE FRUSTRATIONS OF THE LAY PARTIES, WHICH HAVE FELT INCREASINGLY THREATENED BY THE GROWING COOPERATION BETWEEN THE DC AND THE PCI AND WHO SEE (WRONGLY, WE THINK) A "GOVERNMENT OF NATIONAL EMERGENCY" AS THE ONLY PRACTICABLE ANSWER TO THEIR PROBLEMS. AS THE SAME TIME, THE PCI AND THE LAY PARTIES DETECTED AMONG THE DC LEADERS A LACK OF RESOLUTION AND FIRMNESS, A WILLINGNESS TO MAKE SUCH CONCESSIONS TO THE PCI RATHER THAN A DETERMINATION TO LIMIT SUCH CONCESSIONS TO THE ABSOLUTE MINIMUM. FINALLY, SECRET

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THE LACK OF APPARENT SOLUTIONS TO THE PROBLEMS OF PUBLIC VIOLENCE AND POLITICAL TERRORISM, UNEMPLOYMENT, INFLATION, AND HIGH LEVEL SCANDALS HAS CREATED AN INCREASINGLY INSISTENT PUBLIC DEMAND THAT SOLUTIONS BE FOUND. ALL OF THESE

FACTORS CONTRIBUTED TO THE SEPARATE DECISIONS BY THE PRI,
PSI AND PCI TO PRESS HARD FOR THE CREATION OF A "GOVERNMENT
OF NATIONAL EMERGENCY."

PROSPECTS FOR THE FUTURE:

VERY SHORT-TERM

7. THE ECONOMIC AND POLITICAL CRISES WILL ALMOST CERTAINLY COME TO A HEAD IN JANUARY. THE GOVERNMENT'S ECONOMIC POLICY AND THE POLITICAL ARRANGEMENTS TO IMPLEMENT IT WILL BE SUBJECT TO INTENSE NEGOTIATION AMONG THE POLITICAL PARTIES AND THE TRADE UNIONS, WHOSE THREATENED GENERAL STRIKE WILL BE AN IMPORTANT CONDITIONING ELEMENT. THE LEFT WILL PUSH TO EXPAND THE PUBLIC SECTOR DEFICIT AND DOMESTIC CREDIT, THEREBY USING THE PUBLIC SECTOR AS A GENERATOR OF ECONOMIC GROWTH AND EMPLOYMENT. IF SUCH A POLICY IS ADOPTED, THE PRIVATE SECTOR WILL ONCE AGAIN BE LEFT TO BEAR THE BURDEN OF THE STABILIZATION EFFORT. EARLY NEXT YEAR, ITALY WILL PROBABLY WANT TO RENEGOTIATE THE IMF LETTER OF INTENT. GIVEN ITALY'S PERFORMANCE DURING 1977, IT CAN ANTICIPATE THAT THE IMF WILL DEMAND SOME TOUGH CONDITIONS FOR ANY NEW PROGRAM. ITALIAN LEADERS FROM ALL PARTIES ARE AWARE OF ITALY'S NEED TO RETAIN THE CONFIDENCE OF FOREIGN LENDERS IN ORDER TO MAINTAIN AN ADEQUATE LEVEL OF RESERVES, AND RECOGNIZE THE NEED TO HAVE A CREDIBLE PROGRAM WITH THE IMF. THIS AWARENESS SHOULD ACT AS A BRAKE ON THE MORE EXTREME DEMANDS FOR REFLATIONARY POLICIES.

8. THE DISCUSSION OF THE ECONOMIC PACKAGE FOR 1978 WILL BE CONDITIONED BY THE DEMAND FOR PCI PARTICIPATION IN THE GOVERNMENT AS A NECESSARY PREREQUISITE TO SOLVING THE COUNTRY'S ECONOMIC AND SOCIAL PROBLEMS. AS IN THE PAST, THE PCI WILL
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PROBABLY BE PREPARED TO SUPPORT RELATIVELY CONSERVATIVE ECONOMIC POLICIES IN RETURN FOR POLITICAL GAINS. AT THIS STAGE, IT SEEMS UNLIKELY THAT THE PCI WILL INSIST, TO THE POINT OF PRECIPITATING NEW PARLIAMENTARY ELECTIONS, ON FULL PARTICIPATION IN THE GOVERNMENT. INSTEAD, IT IS LIKELY TO DRIVE AS HARD A BARGAIN AS POSSIBLE ON ECONOMIC POLICY AND SEEK "GUARANTEES" THROUGH PARTICIPATION IN THE PARLIAMENTARY MAJORITY AND/OR A GOVERNMENT RESHUFFLE IN WHICH IT WOULD NAME SEVERAL (NON-COMMUNIST, BUT ACCEPTABLE) MINISTERS. THE PCI WILL PROBABLY PREFER THE LATTER SOLUTION BECAUSE IT WILL DEMONSTRATE TO ITS ELECTORATE (AS THE LATTANZIO AFFAIR DID) THAT IT CAN CONDITION THE GOVERNMENT EFFECTIVELY, WHILE SIMPLY BEING IN THE MAJORITY WOULD NOT APPEAR MUCH DIFFERENT FROM PRESENT ARRANGEMENTS TO ITS ELECTORATE.

9. THE DC (ESPECIALLY ANDREOTTI) WILL ATTEMPT TO PRESERVE THE PRESENT GOVERNMENT FORMULA AND TO SATISFY THE DEMANDS OF THE LEFT BY NEGOTIATING AN EXPANSION OF THE SIX PARTY ACCORD.

AT THIS STAGE, THE DC LEADERS APPEAR COMMITTED TO NEW ELECTIONS BEFORE BRINGING THE PCI INTO THE CABINET. THE DC LEADERS APPEAR LESS CLEAR AND FIRM, HOWEVER, IN THEIR ATTITUDE TOWARD THE "GUARANTTES" THAT ARE LIKELY TO BE SOUGHT BY THE LEFT. SINCE MANY BELIEVE THAT THE DC WOULD DO WELL IN A GENERAL ELECTION, AND SINCE THE PCI AND THE LAY PARTIES ARE STRONGLY OPPOSED TO ELECTIONS (FOR DIFFERENT REASONS), THE THREAT OF NEW ELECTIONS WOULD APPEAR TO BE THE DC'S MOST EFFECTIVE BARGAINING TOOL AS WELL AS A WAY OF UNITING THE PARTY, BUT THE PARTY LEADERS TO DATE SHOW NO DISPOSITION TO USE BECAUSE THEY ARE NOT CONVINCED THE COMMUNISTS WOULD LOSE.

10. THE LOGIC OF THE SITUATION THUS SEEMS TO POINT TO AN AGREEMENT IN JANUARY THAT WILL GIVE THE LEFT PART OF WHAT THEY WANT ON ECONOMIC POLICY, TO BE RECORDED IN AN EXPANDED SECRET

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SIX PARTY ACCORD. SUCH AN AGREEMENT WILL PROBABLY BE ACCOMPANIED BY A GOVERNMENT RESHUFFLE IN WHICH 2-4 NON-PARLIAMENTARIANS, ACCEPTABLE TO THE LEFT, WILL RECEIVE ECONOMIC-FINANCIAL MINISTERIAL POSITIONS. OF THESE, ONE OR TWO WILL PROBABLY BE EASILY PALATABLE TO THE DC AND THE WESTERN WORLD (E.G., VISENTINI, CARLI, AGNELLI) WHILE AT LEAST ONE WILL BE A TRUE MAN OF THE LEFT (SPAVANTA IS MOST OFTEN MENTIONED).

SHORT-TERM

11. ONE OF THE MOST IMPORTANT UNKNOWNNS IS WHETHER THE DC WILL TRY TO MOVE TOWARD PARLIAMENTARY ELECTIONS BEFORE JUNE. AT THIS STAGE, IT IS CLEAR THAT NO DECISION HAS BEEN MADE. THE ACTIONS OF LABOR, WHICH THREATENS A GENERAL STRIKE IN JANUARY, COULD BE DECISIVE. IF NO ELECTION IS HELD, THE PRESENT STALEMATE COULD CONTINUE AT LEAST UNTIL EARLY 1979. DURING THAT PERIOD WE CAN EXPECT THAT THE PCI WILL CONTINUE TO MAKE FURTHER INROADS AND IT IS POSSIBLE THAT AN EFFORT WILL BE MADE TO BRING THE PCI INTO THE MAJORITY, IF IT IS NOT ALREADY THERE, DURING THE SIX MONTHS PRIOR TO THE PRESIDENTIAL ELECTION (DECEMBER, 1978) DURING WHICH PARLIAMENT CANNOT BE DISSOLVED.

12. THE PRESIDENTIAL ELECTION ITSELF WILL CONDITION POLITICAL BEHAVIOR OVER THE NEXT TWELVE MONTHS. THE ALLEGED CANDIDATES FOR THE OFFICE ARE MANY: MORO, ANDREOTTI, FANFANI, ZACCAGNINI, LA MALFA, DE MARTINO, ETC. SINCE CURRENT WISDOM HAS IT THAT PCI VOTES ARE NECESSARY FOR ANY ONE OF THEM TO BE ELECTED, IT IS EXPECTED THAT THEIR ATTITUDES ON UNRELATED ISSUES WILL BE AFFECTED. THUS, THE CYNICAL EXPLAIN LA MALFA'S CALL FOR PCI PARTICIPATION IN THE GOVERNMENT, AND FANFANI'S MORE OBLIQUE PRONOUNCEMENT IN THE SAME DIRECTION, AS EXPLICABLE BY THEIR PRESIDENTIAL AMBITIONS. FOR THE SAME REASONS, MORO IS BEING WATCHED CLOSELY. IN THE END, WHILE IT IS FAR TOO EARLY TO MAKE PREDICTIONS ABOUT THAT ELECTION, IT SEEMS

UNLIKELY THAT THE PCI WOULD WELCOME HAVING AN ACTIVE POLITICIAN
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IN THAT OFFICE. IF SO, THEY ARE LIKELY TO LOOK WITH FAVOR
ON SOMEONE MORE PHLEGMATIC LIKE ZACCAGNINI OR DE MARTINO.

MID-TERM

13. FINALLY, IT APPEARS INCREASINBLY PROBABLE THAT, IF PRESENT
TRENDS CONTINUE, THE PCI WILL BE IN THE NATIONAL GOVERNMENT
WITHIN 1-3 YEARS, IF NOT SOONER. UNFORTUNATELY, THERE IS LITTLE
ON WHICH TO BASE ANY HOPE FOR A REVERSAL OF PRESENT TRENDS
IN THAT TIME FRAME. A SUBSTANTIAL CHANGE IN THE DC IS A
PREREQUISITE BUT IT SEEMS UNLIKELY. THE ONLY SHORT TERM
HOPE WOULD APPEAR TO BE A GENERAL ELECTION IN WHICH THE PCI
CLEARLY LOSES GROUND. SUCH AN EVENT COULD (NOT NECESSARILY,
WOULD) STIMULATE THE NECESSARY CHANGES IN THE DC AND THE LAY
PARTIES; IT MIGHT ALSO STIMULATE OR HASTEN CHANGE IN ONE
DIRECTION OR ANOTHER WITHIN THE PCI ITSELF. GARDNER UNQTE
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